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UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF CALIFORNIA

In re:	]	Case No. 05-56449-ASW
	]	
David Dennis Webster,	]	Chapter 7
	]	
Debtor.	]	
_____	]	
Eric G. Shedlarski,	]	Adversary No. 05-5627
	]	
Plaintiff,	]	
vs.	]	
	]	
David Dennis Webster,	]	
	]	
Defendant.	]	
_____	]	

MEMORANDUM DECISION  
DETERMINING DEBT TO BE DISCHARGEABLE

Before the Court is a complaint by Eric G. Shedlarski ("Creditor") against David Dennis Webster, the Debtor in this Chapter 7 case ("Debtor"). The complaint seeks a determination of non-dischargeability for a stipulated judgment of \$8,039.27 plus interest and costs based upon 11 U.S.C. §523(a)(2).<sup>1</sup>

The matter has been tried and submitted for decision. Debtor is represented by Henry B. Niles III, Esq. Creditor is pro se. At

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<sup>1</sup> Unless otherwise noted, all statutory references are to Title 11, United States Code, as amended in 2005 ("Bankruptcy Code").

1 trial, Creditor called himself as witness. Debtor called himself  
2 as witness.

3 This Memorandum Decision constitutes the Court's findings of  
4 fact and conclusions of law, pursuant to Rule 7052 of the Federal  
5 Rules of Bankruptcy Procedure.

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I.

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FACTS

9 Debtor works in the computer industry in business development.  
10 Debtor is not an attorney. Debtor leased residential property  
11 located at 16040 Redwood Lodge Road, Los Gatos, California 95033  
12 (the "Property") to Creditor pursuant to a written lease agreement  
13 dated January 24, 2004. Debtor and his ex-wife formerly utilized  
14 the Property as their residence. Under the lease agreement,  
15 Creditor paid Debtor a security deposit of \$7,000.

16 Creditor vacated the Property on February 8, 2005. Debtor and  
17 Creditor agreed that certain items would be deducted from the  
18 security deposit, leaving \$4,790 of the security deposit owed to  
19 Creditor. Debtor failed to return the \$4,790 to Creditor.  
20 Creditor tried to work with Debtor to obtain the return of the  
21 security deposit to no avail. Creditor hired counsel and, on  
22 March 24, 2005, Creditor sued Debtor in state court for the return  
23 of the \$4,790 deposit, \$9,580 in penalty damages, plus attorneys  
24 fees and costs of suit.

25 In early 2005, Debtor knew he was in financial trouble.  
26 Debtor had not paid the mortgage on the Property since November  
27 2004. Debtor put the Property on the market in January or February  
28 2005. On May 12, 2005, a Notice of Default was recorded against

1 the Property on behalf of Debtor's mortgage lender. On August 24,  
2 2005, a Notice of Trustee's Sale ("Notice") was recorded against  
3 the Property. The Notice set a trustee's sale for September 13,  
4 2005. Debtor attempted to find a buyer for the Property prior to  
5 the trustee's sale. Debtor testified that he believed, on the  
6 basis of his correspondence with real estate professionals, that  
7 there was \$150,000 of equity in the Property in August 2005.  
8 Debtor's realtor held an open house on the Property on August 28,  
9 2005.

10 Debtor represented himself in the state court litigation with  
11 Creditor. A trial was set on or about September 7, 2005. In early  
12 August 2005, Debtor testified that Creditor called Debtor when  
13 Debtor was in Canada visiting relatives. Debtor testified that he  
14 was unable to talk with Creditor at that time and Debtor  
15 established another time to call Creditor.

16 Debtor testified that he returned Creditor's call the next day  
17 and had a fifteen-minute telephone conversation. Debtor testified  
18 that, during that conversation, Debtor told Creditor that the  
19 Property was in foreclosure and that Debtor was contemplating  
20 bankruptcy, but that Debtor anticipated that the Property would  
21 sell before bankruptcy at a price great enough to pay Creditor's  
22 debt. Debtor testified that he also told Creditor that Debtor's  
23 marital difficulties were complicating the sale of the Property.  
24 Debtor distinctly recalled offering Creditor a lien on the Property  
25 in that phone conversation since Debtor believed there was  
26 sufficient equity in the Property to pay such a lien. Debtor did  
27 not recall if Debtor or Creditor initiated the idea of a lien.

28

1            Creditor acknowledged that Debtor communicated with Creditor  
2 and Creditor's state court counsel regarding the state court  
3 action. Creditor testified that he recalled one personal telephone  
4 call with Debtor in August 2005 that lasted about five minutes.  
5 Creditor testified that Creditor was aware of Debtor's financial  
6 distress during the relevant time period and knew that the Property  
7 was for sale. Creditor was also aware that Debtor and his wife  
8 were separated. Creditor maintained that he was unaware that the  
9 Property was in foreclosure.

10            On the eve of the state court trial, Creditor's counsel  
11 confirmed with Debtor that Debtor had agreed to a lien on the  
12 Property, and Creditor and Debtor entered into a stipulated  
13 judgment in the state court action. Pursuant to the stipulated  
14 judgment filed on September 7, 2005, Creditor agreed to reduce his  
15 claim from approximately \$14,500.00 to \$8,039.27 and to forebear  
16 from further collection actions. The parties also agreed that the  
17 stipulated judgment would operate as a lien on the Property.

18            Creditor testified that Debtor failed to mention the pending  
19 foreclosure proceedings during the settlement negotiations.  
20 Creditor asserted that he would not have entered into the  
21 stipulated judgment if he had known of the pending foreclosure  
22 proceedings. Creditor testified that he did not believe that  
23 either a judgment or a judgment lien guaranteed payment of what  
24 Debtor owed Creditor.

25            Debtor testified that during this period, Debtor was under the  
26 mistaken belief of fact and law that, if he provided Creditor with  
27 a judgment lien against the Property, that lien would survive a  
28 non-judicial foreclosure sale under California law. Debtor

1 believed in August and September 2005 that at a foreclosure sale,  
2 the Property would be subject to auction and would sell at the  
3 highest price and all liens on the Property would be paid in order  
4 of preference, i.e., that Creditor's junior lien would be paid as  
5 part of the foreclosure.

6 The trustee's sale took place on September 13, 2005, and the  
7 Property reverted to the lender. Debtor filed for bankruptcy on  
8 September 29, 2005. Creditor testified that he did not learn of  
9 the foreclosure sale until November 15, 2005. Creditor filed this  
10 action on December 27, 2005.

11 Debtor asserts there was no factual basis for Creditor's non-  
12 dischargeability complaint and seeks an award of fees and costs  
13 under 11 U.S.C. §523(d).

14  
15 II.

16 APPLICABLE LAW

17 A debt arising from actual fraud "other than a statement  
18 respecting the debtor's or an insider's financial condition" is  
19 excepted from a Chapter 7 discharge pursuant to §523(a)(2)(A). The  
20 elements of a claim under this statute are:

21 (1) a representation, fraudulent omission or deceptive  
22 conduct by the debtor;

23 (2) knowledge of the falsity or deceptiveness of his  
24 statement or conduct;

25 (3) an intent to deceive;

26 (4) justifiable reliance by the creditor on the debtor's  
27 statement or conduct;

28

1 (5) damage to the creditor proximately caused by its reliance  
2 on the debtor's statement or conduct.

3 In re Harmon, 250 F.3d 1240, 1246 (9th Cir. 2001).

4 "A debtor's failure to disclose material facts constitutes a  
5 fraudulent omission under §523(a)(2)(A) if the debtor was under a  
6 duty to disclose and the debtor's omission was motivated by an  
7 intent to deceive." Harmon, 250 F.3d at 1246 n.4.

8 Absent a duty to disclose, the intent that must be shown for a  
9 determination of nondischargeability under §523(a)(2)(A) is actual  
10 intent, not merely intent implied in law, or constructive intent,  
11 Id. at 1249 n.10.

12 "Regardless of whether one is under a duty to speak or  
13 disclose facts, one who does speak must speak the whole truth, and  
14 not by partial suppression or concealment make the utterance  
15 untruthful and misleading." American Trust Co. v. California  
16 Western States Life Ins. Co., 15 Cal. 2d 42, 65 (1940).

17 The fact that a party had "constructive notice of the truth  
18 from public records is no defense to fraud." Bishop Creek Lodge v.  
19 Scira, 46 Cal. App. 4th 1721, 1734 (1996). The existence of such  
20 records "may be relevant to whether the victim's reliance was  
21 justifiable, but it is not, by itself, conclusive." Id.

22 The Bankruptcy Code is "designed to afford debtors a fresh  
23 start, and we interpret liberally its provisions favoring debtors."  
24 In re Bugna, 33 F.3d 1054, 1059 (9th Cir. 1994). The Code's  
25 limited exceptions to the general policy of discharge are to be  
26 construed narrowly. In re Riso, 978 F.2d 1151, 1154 (9th Cir.  
27 1992).

28



1 returned Creditor's call. Debtor emphasized that he included the  
2 foreclosure in his notes and reiterated that he described his  
3 financial trouble, his plans to sell the Property, his marital  
4 problems, and the pending foreclosure during the fifteen minute  
5 conversation with Creditor.

6 Creditor testified that he recalled having a phone  
7 conversation with Debtor in August 2005 and also testified that he  
8 knew the Property was for sale, that Debtor was experiencing  
9 marital problems, and that Debtor was in financial trouble.  
10 Creditor testified that he did not know about the pending  
11 foreclosure. Creditor indicated that Creditor's counsel, who  
12 represented Creditor in the state court action, may have received  
13 such a call from Debtor about the pending foreclosure. Creditor's  
14 counsel did not testify and Creditor did not present any other  
15 evidence to rebut Debtor's testimony that Debtor informed Creditor  
16 of the foreclosure.

17 Debtor and Creditor presented equally credible testimony. The  
18 Court believes that Creditor is sure that Debtor did not tell him  
19 of the pending foreclosure. It is possible that Debtor thought he  
20 told Creditor of the foreclosure but did not, e.g., because Debtor  
21 was sure Creditor would get paid on his lien even in a foreclosure.  
22 It also is very possible that Debtor informed Creditor's counsel,  
23 but not Creditor, of the pending foreclosure. That is perhaps the  
24 most likely scenario of what occurred. Either way, Debtor's  
25 conduct does not constitute fraud.

26 The parties agreed to settle their state court dispute on  
27 terms that included a judgment lien against the Property in the  
28 amount of \$8,039.27. A judgment lien is of speculative value and

1 the lien's worth turned on the ultimate exchange price of the  
2 Property. The Property did not fetch a high enough price to pay  
3 all claims against it, and Creditor received no compensation post-  
4 sale. Had the Property sold on different terms, however,  
5 Creditor's lien might well have entitled him to payment.

6 Creditor asserts that Debtor was aware at the time of the  
7 settlement negotiations that the judgment lien would not survive  
8 the pending foreclosure sale and Debtor therefore knew that  
9 Debtor's failure to mention the foreclosure was deceptive. Debtor  
10 credibly testified that he had no such knowledge.

11 Debtor testified that he in fact anticipated that the Property  
12 would sell at a high enough price that the Creditor's junior lien  
13 would have been paid. Debtor testified that the Property had a  
14 mortgage of \$800,000 and that he believed the Property would sell  
15 for \$1,060,000. Debtor further testified that the experienced real  
16 estate professionals with whom Debtor dealt failed to anticipate  
17 the low sale price at which the Property ultimately transferred.  
18 To corroborate Debtor's testimony, Debtor admitted documents  
19 indicating that the Property had a listing price of \$1,060,000 when  
20 Debtor and Creditor entered settlement negotiations. Debtor also  
21 testified that he was under the mistaken belief of fact and law  
22 that, if the Property underwent a foreclosure sale, an auction  
23 would take place and all liens would be paid.

24 Creditor presented no evidence to rebut Debtor's credible  
25 testimony other than his own equally credible testimony. Creditor  
26 did not prove by a preponderance of the evidence that Debtor knew  
27 or should have known of the judgment lien's worthlessness.  
28 Accordingly, it cannot be found that Debtor knew that a failure to

1 mention the foreclosure would be deceptive. Whether or not Debtor  
2 informed Creditor or Creditor's counsel of the pending foreclosure,  
3 Debtor's conduct did not constitute fraud because Debtor lacked the  
4 requisite intent. Harmon, 250 F.3d at 1249 n.10.

5 Creditor did not prove by a preponderance of the evidence that  
6 Debtor intended to or acted with the purpose of deceiving Creditor.  
7 Creditor did not introduce any evidence to suggest that he was  
8 justified in his reliance on Debtor's representations. The Court  
9 notes in this regard that Creditor does not allege that Debtor  
10 represented that the Property was not in foreclosure. Debtor  
11 argues that Creditor was represented by counsel in the state court  
12 action and that it was the responsibility of Creditor's counsel to  
13 investigate the status of the Property. The Notice was a matter of  
14 public record and Creditor's failure to investigate the status of  
15 the Property by himself or by his counsel may not constitute  
16 justifiable reliance. Bishop Creek, 46 Cal. App. 4th at 1734.

17 As for damages, Debtor argues that if Creditor had gone to  
18 trial rather than accept the stipulated judgment lien, Creditor  
19 would have, at best, received a judgment lien like the one offered  
20 by Debtor during the settlement negotiations and that such a lien  
21 also would not have survived the foreclosure sale. On this basis,  
22 Debtor argues that the alleged fraud left Creditor in the same  
23 position among other creditors that he would have held had Creditor  
24 proceeded with his state court claim.

25 Debtor's argument assumes Creditor was faced with only two  
26 options -- pursue the state court action and, if successful,  
27 recover a judgment lien, or agree to a stipulated judgment and  
28 accept a lien as settlement. Creditor testified that, had he known

1 of the foreclosure, Creditor might have sought alternative  
2 consideration during the settlement negotiations. Creditor's  
3 testimony was vague and speculative and Creditor failed to  
4 substantiate his argument that he would have acted differently if  
5 he had knowledge of the pending foreclosure sale. Creditor did not  
6 prove by a preponderance of the evidence that he suffered damage as  
7 a result of Debtor's alleged fraud.

8 **2. Costs and Attorney's Fees Under Section 523(d)**

9 Debtor seeks recovery of his attorney's fees and costs  
10 incurred during the course of this adversary proceeding under 11  
11 U.S.C. §523(d). Bankruptcy Code Section 523(d) provides:

12 If a creditor requests a determination of  
13 dischargeability of a consumer debt under subsection  
14 (a)(2) of this section, and such debt is discharged, the  
15 court shall grant judgment in favor of the debtor for the  
16 costs of, and a reasonable attorney's fee for, the  
proceeding if the court finds that the position of the  
creditor was not substantially justified, except that the  
court shall not award such costs and fees if special  
circumstances would make the award unjust.

17 A consumer debt is defined in Bankruptcy Code Section 101(8) as  
18 "debt incurred by an individual primarily for a personal, family,  
19 or household purpose."

20 Once a debtor establishes that the obligation is a  
21 dischargeable consumer debt, the burden shifts to the creditor to  
22 show that the position of the creditor was "substantially  
23 justified" or that "special circumstances" would make the award  
24 unjust. In re Stine, 254 B.R. 244, 249 (9th Cir. BAP 2000). The  
25 standard of substantial justification is met if the creditor  
26 demonstrates a reasonable basis in law or fact to file an action.  
27 Id.

28

1 Here, Debtor failed to establish that the discharged debt is a  
2 consumer debt. The debt here is comprised of an unreturned  
3 security deposit that arose from the relationship of Debtor and  
4 Creditor as landlord and tenant. Debtor testified that Debtor's  
5 activity as a landlord was clearly second to Debtor's primary  
6 career in the computer industry. It was while conducting business  
7 as a landlord that Debtor became obligated to Creditor. Debts  
8 related to rental activity incurred by part-time landlords are not  
9 consumer debts under Section 101(8). In re Pedigo, 296 B.R. 485,  
10 491 (Bankr. S.D. Ind. 2003).<sup>2</sup> In Pedigo, a retired widower  
11 incurred a loan accrued to prepare his property for use by a  
12 tenant. The Pedigo court determined that the debtor's dealings as  
13 a part-time landlord were business oriented and held that the debt  
14 was not a consumer debt. Id. Here Debtor's obligation to Creditor  
15 likewise developed from Debtor's dealings as a part-time landlord  
16 when he leased the Property to Creditor. Under Pedigo, the debt in  
17 this case is not a consumer debt.

18 Debtor also asserts that Creditor lacked substantial  
19 justification to bring this action. Debtor asserts Debtor's  
20 actions or omissions were not fraudulent. Debtor also argues that  
21 whether or not Creditor agreed to accept the stipulated judgment  
22 lien as consideration for settling the state court action, Creditor  
23 would have received such a judgment lien after trial and that,  
24 therefore, Creditor had no grounds to assert that Creditor suffered  
25 damage as a result of fraud as a matter of law. Debtor's argument  
26 assumes Creditor was faced with only two options -- pursue the

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27  
28 <sup>2</sup> The Pedigo court interpreted Bankruptcy Code §101(7), the predecessor section to  
Bankruptcy Code §101(8). Bankruptcy Code §101(8) continues former Bankruptcy Code §101(7)  
without change.

1 state court action and, if successful, recover a judgment lien, or  
2 agree to a stipulated judgment and accept a lien as settlement.  
3 The Court disagrees with Debtor.

4 First, Creditor waived any penalty damages by settling with  
5 Debtor. Had Creditor proceeded to trial rather than settle with  
6 Debtor, Creditor might have obtained a larger judgment. Second,  
7 Creditor suggested that, had he known of the foreclosure, Creditor  
8 might have sought alternative consideration for settlement and that  
9 Creditor thereby suffered damage as a result of fraud and had a  
10 reasonable basis in law to assert his claim. Debtor did not  
11 introduce evidence to rebut Creditor's testimony. Finally, the  
12 Court notes that a material fact was in dispute, e.g., whether or  
13 not Debtor informed Creditor of the pending foreclosure. It was  
14 necessary for the Court to review substantial testimony in order to  
15 make a determination on that matter.

16 In sum, Creditor demonstrated that Creditor had a reasonable  
17 basis in law and in fact to assert his §523(a)(2) action. Stine,  
18 254 B.R. at 249. Accordingly, the Court finds that Creditor had  
19 substantial justification for filing this claim and Debtor's  
20 request for fees and costs is denied. Id.

21  
22 CONCLUSION

23 For the foregoing reasons, the claim asserted by Creditor  
24 against Debtor is discharged under 11 U.S.C. §523(a). Debtor's  
25 request for attorney's fees and costs under 11 U.S.C. §523(d) is

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1 denied. Counsel for Debtor shall submit a proposed judgment after  
2 review by Creditor as to form.

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5 Dated:

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ARTHUR S. WEISSBRODT  
UNITED STATES BANKRUPTCY JUDGE

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1 Court Service List

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4 Ben Lomond, CA 95005

4 David Dennis Webster  
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6 Henry B. Niles, III, Esq.  
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9 Santa Cruz, CA 95062

8 Chapter 7 Trustee  
9 John W. Richardson  
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11 U.S. Trustee  
12 Office of the U.S. Trustee / SJ  
13 U.S. Federal Bldg.  
14 280 S 1st St. #268  
15 San Jose, CA 95113-3004

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